

1 HONORABLE RICHARD A. JONES
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7 UNITED STATES DISTRICT COURT
8 WESTERN DISTRICT OF WASHINGTON
9 AT SEATTLE

10 NORTH SEATTLE COMMUNITY
11 COLLEGE FOUNDATION,

12 Plaintiff,

13 v.

14 GREAT AMERICAN E&S INSURANCE
15 COMPANY,

Defendant.

CONSOLIDATED WITH C09-1259RAJ

LEAD CASE NO. C09-635RAJ

ORDER

(APPLIES TO ALL ACTIONS)

16 **I. INTRODUCTION**

17 This matter comes before the court on cross-motions for summary judgment.
18 Although the parties requested oral argument, the court finds their motions suited for
19 disposition based on their briefs and accompanying evidence. As stated below, the court
20 GRANTS the motion (Dkt. # 31) of Defendant Great American E&S Insurance Company
21 (“Great American) in part and DENIES it in part, and DENIES the motion (Dkt. # 33) of
22 Plaintiff North Seattle Community College Foundation (the “Foundation”).

23 **II. BACKGROUND**

24 The Foundation, a Seattle organization existing for the benefit of North Seattle
25 Community College, operates a credit counseling service.¹ One of its credit services was

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27 ¹ The Foundation operates its credit counseling service through an arm known as American
Financial Services. For simplicity, the court refers solely to the Foundation.

1 the creation and oversight of debt management plans with individuals with financial
2 trouble. The Foundation negotiated with each of its customers' creditors to reduce his or
3 her debts and consolidate them into a single monthly payment that it collected from each
4 customer and used to pay his or her creditors.

5 In October 2007, Sherry Craft, one of the Foundation's customers, filed a class
6 action in Georgia state court against the Foundation and others, alleging violations of
7 Georgia's Debt Adjusting Act ("GDAA"). Ga. Code Ann. § 18-5-1 to 18-5-4. The
8 amended complaint raised two claims on behalf of all of the Foundation's Georgia
9 customers. First, the complaint alleged that the Foundation had collected a monthly fee
10 of more than 7.5% of each customer's monthly debt in violation of the GDAA:

11 In the course of engaging in debt adjusting, it shall be unlawful for any
12 person to accept from a debtor who resides in this state, either directly or
13 indirectly, any charge, fee, contribution, or combination thereof in an
amount in excess of 7.5 percent of the amount paid monthly by such debtor
to such person for distribution to creditors of such debtor

14 Ga. Code Ann. § 18-5-2. Second, the complaint alleged that while violating the GDAA,
15 the Foundation had accepted "fair share contribution" payments from its customers'
16 creditors, which are essentially fees that creditors paid the Foundation in exchange for the
17 payments they received. As to the first claim, Ms. Craft sought "as damages an amount
18 equal to the total of all fees, charges, contributions or combination thereof paid by
19 Plaintiff . . . and all other sums allowed under OGCA §§ 18-5-1, *et seq.*" Compl. ¶ 56.
20 As to the second claim, she demanded "disgorgement from Defendants the amounts
21 unjustly gained . . . through these so-called 'fair share contributions' and . . . any amounts
22 awarded by this Court in this cause for Defendants' unjust gain." Compl. ¶ 61. The
23 prayer for relief at the end of her complaint sought the same relief.
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25 On November 6, 2007, the Foundation notified Defendant Great American
26 Insurance Company ("Great American") of the Craft lawsuit. Great American had issued
27 a professional liability insurance policy (the "Policy") covering the Foundation from July
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1 14, 2007 through July 14, 2008. The Policy was subject to a \$50,000 self-insured
2 retention. The Foundation also had an insurance policy from AIG, and notified AIG of
3 the Craft lawsuit as well. AIG agreed to provide a defense to NCSSF, subject to a
4 reservation of rights.

5 Great American and the Foundation, through their counsel, quickly began
6 discussions regarding coverage for the Craft lawsuit. On December 27, 2007, Great
7 American's counsel summarized its position, analyzing the coverage provisions and
8 exclusions of the Policy. Sternberg Decl. (Dkt. # 35), Ex. H. The letter did not take a
9 coverage position, however, and instead concluded with the following equivocation:

10 [T]here are some substantive coverage issues raised and serious questions
11 as to whether the [Policy] provide[s] coverage, including any duty to
12 defend. . . . [T]o the extent the [Policy] would apply, the self-insured
13 retention would be applicable in any event. This provides us with some
14 time to review these issues, discuss their impact on any potential coverage
under the Great American policy and determine whether more definitive
positions need to be taken.

15 *Id.* From this initial salvo, the parties began an exchange of letters and other
16 communications that stretched on for months. The court need not recount the parties'
17 back-and-forth; it suffices to observe that Great American continued to insist that the
18 Policy might not provide coverage for various reasons, the Foundation continued to
19 disagree, and Great American never took a formal position. By July 2008, the parties not
20 only reached an impasse, they apparently ceased communicating with each other.

21 Despite failing to inform its insured of its coverage position, Great American sued
22 the Foundation in January 2009 in the United States District Court for the Middle District
23 of Georgia. By that time, the Craft lawsuit had been removed to the same court. Great
24 American sought declaratory judgment that it had neither an obligation to defend the
25 Foundation nor to indemnify it. The Foundation filed its own suit in this court, alleging
26 that Great American had breached the Policy and had acted in bad faith. The Foundation

1 also successfully moved to transfer Great American's Georgia declaratory judgment suit
2 to this forum. This court consolidated the two actions after the transfer.

3 The Foundation settled claims against it in the Craft litigation in December 2009.
4 Keaton Decl. (Dkt. # 40) ¶ 2. It agreed to pay \$1,025,000. *Id.* ¶ 3. Of the settlement
5 payment, AIG contributed only \$25,000, although it apparently paid all but \$25,000 of
6 the Foundation's defense costs. *Id.* The Foundation estimates its defense costs at just
7 over \$1,000,000. *Id.* ¶ 4. Although Great American was present for settlement
8 negotiations in the Craft lawsuit, it contributed nothing to the settlement. *Id.* ¶¶ 2-3.

9 Now before the court are two summary judgment motions. Great American seeks
10 summary judgment, arguing that it has no duty to defend or indemnify NSCFF and that it
11 did not act in bad faith. NSCFF seeks partial summary judgment that Great American
12 owed it a duty to defend the Craft litigation, and that Great American is liable for its
13 attorney fees.

14 III. ANALYSIS

15 On a motion for summary judgment, the court must draw all inferences from the
16 admissible evidence in the light most favorable to the non-moving party. *Addisu v. Fred*
17 *Meyer, Inc.*, 198 F.3d 1130, 1134 (9th Cir. 2000). Summary judgment is appropriate
18 where there is no genuine issue of material fact and the moving party is entitled to a
19 judgment as a matter of law. Fed. R. Civ. P. 56(c). The moving party must initially show
20 the absence of a genuine issue of material fact. *Celotex Corp. v. Catrett*, 477 U.S. 317,
21 323 (1986). The opposing party must then show a genuine issue of fact for trial.
22 *Matsushita Elect. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586 (1986). The
23 opposing party must present probative evidence to support its claim or defense. *Intel*
24 *Corp. v. Hartford Accident & Indem. Co.*, 952 F.2d 1551, 1558 (9th Cir. 1991). The
25 court defers to neither party in answering legal questions. *See Bendixen v. Standard Ins.*
26 *Co.*, 185 F.3d 939, 942 (9th Cir. 1999).

1 The court now applies this standard to determine whether the Policy covered the
2 Claims in the Craft litigation, whether Great American had a duty to defend or indemnify
3 the Foundation, and whether Great American acted in bad faith.

4 **A. The Craft Lawsuit Raised Only Claims That the Policy Did not Cover.**

5 In Washington, insurance policy interpretation is a purely legal question. *Overton*
6 *v. Consol. Ins. Co.*, 38 P.3d 322, 325 (Wash. 2002). The court must give the terms of the
7 policy a “fair, reasonable, and sensible construction as would be given to the contract by
8 the average person purchasing insurance.” *Id.* (internal quotation omitted). Terms
9 defined within a policy are to be construed as defined, while undefined terms are given
10 their ordinary meaning. *Boeing Co. v. Aetna Cas. & Sur. Co.*, 784 P.2d 507, 511 (Wash.
11 1990). If policy language on its face is fairly susceptible to two different but reasonable
12 interpretations, ambiguity exists, and the court will apply the interpretation most
13 favorable to the insured. *Allstate Ins. Co. v. Peasley*, 932 P.2d 1244, 1246 (Wash. 1997)
14 (cited in *Petersen-Gonzales v. Garcia*, 86 P.3d 210 (2004)); *Allstate Ins. Co. v.*
15 *Hammonds*, 865 P.2d 560, 562 (Wash. Ct. App. 1994) (ambiguity exists “when, reading
16 the contract as a whole, two reasonable and fair interpretations are possible.”). Absent
17 evidence that the parties negotiated the terms of the insurance policy, a court must
18 construe ambiguity against the insurer “even where the insurer may have intended
19 another meaning.” *Allstate*, 865 P.2d at 562.

20 The court’s application of the Policy to the Craft complaint requires it in each
21 instance to carefully consider the nature of the relief that the complaint sought. The
22 Foundation charged its customers a fee for its services, in the sense that each customer
23 paid more to the Foundation than the Foundation paid to the customer’s creditors. This
24 practice is not *per se* unlawful. When the fee exceeds 7.5% of the customer’s debt
25 payment, however, the practice runs afoul of the GDAA. Ga. Code Ann. § 18-5-2. The
26 only statutory remedy available to a customer for that violation, which the GDAA
27 describes as a “*Penalty* for unlawfully engaging in the business of debt adjusting,” is
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1 liability “for an amount equal to the total of all fees, charges, or contributions paid by the
2 debtor plus \$5,000.00.”² Ga. Code Ann. § 18-5-4(b)(2) (emphasis added to statutory
3 heading). This remedy is, to say the least, not purely compensatory. To compensate
4 consumers for being charged a fee in excess of 7.5%, they need only be awarded that
5 portion of their fee that exceeds 7.5%. The Georgia legislature apparently thought a
6 compensatory remedy insufficient, and thus added two components. One is a refund of
7 portion of the fee that does not exceed 7.5%. The other is a \$5000 award that is awarded
8 without reference to the amount charged or overcharged. Thus, for a consumer whose
9 monthly debt was \$100, a debt adjuster could lawfully charge a fee of \$7.50 per month.
10 A debt adjuster who charged \$7.51 per month for service on the same debt would violate
11 the GDAA, but would cost the consumer only a penny above what a GDAA-compliant
12 adjuster could charge. The consumer, however, would receive not merely the penny that
13 she overpaid, but the remainder of the fee she paid (\$7.50), plus \$5000.

14 The fourth component of the relief sought in the Craft lawsuit is disgorgement of
15 the Foundation’s fair share contributions from creditors. This remedy is not at all
16 compensatory. The complaint does not plead that the collection of fair share
17 contributions violates the GDAA. It pleads instead that because the Foundation received
18 fair share contributions while violating the GDAA, it should be forced to disgorge those
19 contributions to plaintiffs.

20 Having considered the relief requested in the Craft lawsuit in this way, it is
21 apparent that the Policy does not provide coverage for any component of the relief
22 sought. The path to reaching that conclusion begins with the Policy’s core coverage
23 clause, which provides as follows:

24 The Company shall pay on behalf of the Insured those sums . . . which the
25 Insured shall become legally obligated to pay as a result of CLAIMS

26 ² The statute provides for other penalties, including conviction of a misdemeanor and a “civil
27 fine” of at least \$50,000, but only the Georgia Attorney General is authorized to obtain those
penalties. Ga. Code Ann. § 18-5-4(a), (b)(1), (c).

1 FIRST MADE AGAINST THE INSURED AND REPORTED TO THE
2 COMPANY DURING THE POLICY PERIOD . . . caused by any
3 Wrongful act for which the Insured is legally responsible and arising out of
the rendering or failure to render professional services

4 Policy, Page 1 of 9, ¶ 1.A. There is no dispute that Ms. Craft made her claim against the
5 Foundation during the policy period and that the Foundation timely reported the claim to
6 Great American. The Policy defines “Claim” as follows:

7 “Claim” means a demand received by the insured for money damages and
8 alleging a wrongful act including the service of suit Claim does not
9 include a demand for equitable, non-pecuniary or injunctive relief, or for
legal fees or expenses in connection therewith.

10 Policy, Page 2 of 9, ¶ II.B. “Damages,” in turn, is defined as follows:

11 “Damages” means monetary judgments or settlements, but does not include
12 fines or statutory penalties, sanctions, whether imposed by law or
13 otherwise, punitive or exemplary damages, [or] the multiplied portion of
multiplied damages

14 Policy, Page 2 of 9, ¶ II.D.³

15 The court concludes that the \$5000 that must be added to any GDAA award to a
16 debtor is a “statutory penalty” within the meaning of the Policy. The statute itself calls
17 every component of an award to a debtor a “penalty,” but the court does not rely on the
18 statute’s characterization.⁴ The \$5000 award is a fixed amount that must be assessed for
19 any proven violation of the statute. That component of the award is not compensatory.
20 Indeed, as the court noted, a violation of the statute that costs the debtor only pennies will
21 cost the defendant engaged in unlawful debt adjusting at least \$5000. The Foundation’s

23 ³ The parties devote inordinate attention in their briefs to what “damages” means in an insurance
24 policy. *E.g.*, Def.’s Br. (Dkt. 31) at 9-11. Every case they cite addresses a policy in which
“damages” is undefined. This Policy, however, explicitly defines damages as any “monetary
25 judgments or settlements,” excluding only particular types of monetary judgments.

26 ⁴ For example, the GDAA permits debtors to recover the portion of a debt adjustment fee that
27 exceeds 7.5%, precisely compensating them for the harm arising from the unlawful practice of
charging in excess of 7.5%. This relief is compensatory, and does not become a “statutory
penalty” within the meaning of the Policy merely because the statute decrees it to be a “penalty.”

1 sole argument for construing this award as something other than a penalty is that a
2 penalty must be levied by a government actor. That limitation appears nowhere in the
3 Policy. A statute that imposes a \$5000 fee without regard to the damage caused by a
4 defendant unambiguously imposes a penalty, and nothing in the Policy suggests that the
5 Policy meant something else by “statutory penalty.”⁵

6 The Policy does not provide coverage for the \$5000 component of the relief
7 sought in the Craft lawsuit; and the court concludes that the Policy’s exclusions bar
8 coverage for the remaining components. An insurer seeking to rely on a policy exclusion
9 bears the burden of proving that the exclusion applies. *Weyerhaeuser Co. v. Commercial*
10 *Union Ins. Co.*, 15 P.3d 115, 127 (Wash. 2000). Only where an exclusion “clearly and
11 unambiguously applies to bar coverage” can the insurer rely on it. *Hayden v. Mutual of*
12 *Enumclaw Ins. Co.*, 1 P.3d 1167, 1172 (Wash. 2000).

13 The court begins with the Policy’s exclusion for any claim “for the disgorgement
14 or reimbursement of monies collected by the Insured.” Policy, Credit Counselors
15 Limitation Endorsement, ¶ 15. The court concludes that the Craft plaintiffs’ claim for
16 disgorgement of fair share contributions unambiguously falls within the scope of this
17 exclusion. In reaching this conclusion, the court does not rely solely on the complaint’s
18 explicit characterization of the relief requested as “disgorgement.” The court’s
19 conclusion is driven by the fact that no other label describes the nature of the relief
20 requested. The Craft plaintiffs’ claim for fair share contributions is not compensatory or
21 restitutionary, it is purely an effort to ensure that the Foundation does not profit from
22 unlawful activity. It is a classic disgorgement remedy.

23 The court also concludes that the Craft plaintiffs’ claim for recovery of the first
24 7.5% of the fees the Foundation collected from them is a claim for disgorgement. As the
25 court noted, debt adjusters may lawfully charge a fee of up to 7.5% for their services.

26 ⁵ Great American offers extrinsic evidence that amounts to the opinion of various people on
27 whether the GDAA imposes a “penalty.” Even if the court were permitted to consider that
extrinsic evidence, none of it addresses what the *Policy* means by “statutory penalty.”

1 Only fees that exceed that percentage are unlawful. A customer of an unlawful debt
2 adjuster can claim to be damaged by fees in excess of 7.5%, but absent a statute
3 providing otherwise, they would have no claim to a compensatory award that included
4 the portion of the fee that does not exceed 7.5%. The GDAA is not merely
5 compensatory, it permits plaintiffs to obtain even the otherwise lawfully collected portion
6 of the fee. This is unambiguously a claim “for the disgorgement . . . of monies collected
7 by the Insured,” and thus falls within that Policy exclusion.

8 The court next turns to the Policy’s exclusion for “any claim based upon or arising
9 out of . . . the Insured gaining in fact any personal profit, or advantage to which such
10 Insured was not legally entitled.” Policy, Page 3 of 9, ¶ III.H. By law, the Foundation
11 was not permitted to collect fees in excess of 7.5% of a customer’s monthly debt. The
12 Craft plaintiffs’ efforts to recover those excessive fees was unambiguously a claim for
13 “personal profit, or advantage to which such Insured was not legally entitled.”

14 For the reasons stated above,⁶ the court concludes that each of the four
15 components of the relief that the Craft plaintiffs requested was not a claim that the Policy
16 covered. The plaintiffs sought disgorgement of the component equal to 7.5% of each
17 plaintiff’s monthly debt, as well as the fair share contributions that the Foundation
18 received from creditors. Their effort to recover the amount of the fee the Foundation
19 charged that exceeded 7.5% was a claim arising out of the Foundation gaining personal
20 profit to which it was not legally entitled. Their effort to obtain a \$5000 award was a
21 claim for a statutory penalty. No sum that the Craft plaintiffs sought from the Foundation
22 was covered by the Policy. Great American had no duty to indemnify the Foundation.

23 **B. Great American Did Not Owe a Duty to Defend.**

24 An insurer’s duty to defend its insured is broader than its duty to indemnify. *Woo*
25 *v. Fireman’s Fund Ins. Co.*, 164 P.3d 454, 459 (Wash. 2007). The complaint in a lawsuit

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27 ⁶ Great American invoked several other policy exclusions, and also contended that the Policy
was excess to AIG’s policy. The court need not reach any of these issues.

1 filed against the insured is the trigger for the duty to defend. *Id.* An insurer must
2 examine the allegations in the complaint, construe them liberally, and determine whether,
3 if proven, the allegations would impose a liability on the insured that the policy would
4 cover. *Id.*; *see also Truck Ins. Exchange v. Vanport Homes, Inc.*, 58 P.3d 276, 281-82
5 (Wash. 2002). Only where it would benefit the insured can the insurer look beyond the
6 complaint itself:

7 There are two exceptions to the rule that the duty to defend must be
8 determined only from the complaint, and both the exceptions favor the
9 insured. If coverage is not clear from the face of the complaint but may
10 exist, the insurer must investigate the claim and give the insured the benefit
11 of the doubt in determining whether the insurer has an obligation to defend.
12 . . . Similarly, facts outside the complaint may be considered if (a) the
13 allegations are in conflict with facts known to or readily ascertainable by
14 the insurer or (b) the allegations of the complaint are ambiguous or
15 inadequate.

16 *Truck Ins. Exchange*, 58 P.3d at 282 (internal citations and quotations omitted).

17 Great American had no duty to defend. For the reasons stated in the previous
18 section, the Craft complaint itself gave Great American no reason to provide the
19 Foundation with a defense. Nothing in the complaint conceivably seeks damages that the
20 Policy would cover. The record reflects that Great American conducted further
21 investigation, including several discussions with Foundation officials and the
22 Foundation’s counsel. Nothing in the record, however, shows that the Foundation
23 discovered anything in its investigation that would have overcome the complaint’s failure
24 to raise a covered claim. For that reason, the court concludes that Great American had no
25 duty to defend the Foundation as a matter of law.

26 **C. The Court Cannot Resolve the Foundation’s Bad Faith Claims as a Matter of
27 Law.**

28 Having concluded that Great American had neither an obligation to defend the
Foundation in the Craft lawsuit nor to indemnify it, only the Foundation’s bad faith claim
remains. The Foundation makes both a common law claim for a bad faith breach of the
Policy and a bad faith claim invoking the Washington Consumer Protection Act (“CPA”).

1 There is evidence to support both bad faith claims. Typically, a finding that the
2 insurer had no duty to defend or indemnify would be dispositive of a contractual bad faith
3 claim. *Am. States Ins. Co. v. Symes of Silverdale, Inc.*, 78 P.3d 1266, 1269 (Wash. 2003)
4 (stating that bad faith requires an “unreasonable, frivolous, or unfounded” breach of an
5 insurance contract). In this case, however, while the court concludes that Great American
6 did not breach the Policy by failing to defend or indemnify, it may have otherwise
7 breached the Policy. And it certainly may have breached one or more of the dozens of
8 regulations incorporated into the CPA that govern an insured’s obligation to process an
9 insured’s claim, to promptly notify the insured of coverage determinations, and to resolve
10 coverage disputes without unduly harming the insured. For reasons it does not explain,
11 Great American steadfastly refused to take a coverage position for more than a year. It
12 neither took up the Foundation’s defense nor declined to provide one; it neither promised
13 coverage nor stated conclusively that it would not provide coverage. Then, with
14 apparently no warning, it sued the Foundation in Georgia. Whether this conduct harmed
15 the Foundation is an open question. *Safeco Ins. Co. of Am. v. Butler*, 823 P.2d 499, 503
16 (Wash. 1992) (“a showing of harm is an essential element of an action for bad faith
17 handling of an insurance claim”). The court must presume harm, however, if an insured
18 proves bad faith. *Id.* at 504. While Great American refused to state its position, the
19 Foundation was attempting to resolve the Craft litigation, a process in which cooperation
20 and straightforward communication from its insurers would likely have been to its
21 strategic benefit. Moreover, by suing its insured in another state, it arguably caused the
22 Foundation to incur costs it should not have had to pay, such as the cost of litigating over
23 transferring the litigation here. On this record, the court cannot conclude that the
24 Foundation suffered harm as a matter of law from Great American’s conduct, but it
25 cannot rule out the possibility either. The Foundation’s bad faith claims will proceed to
26 trial.

IV. CONCLUSION

For the reasons stated above, the court GRANTS Great American's motion for summary judgment (Dkt. # 31) to the extent it seeks a declaratory judgment that it was neither obligated to defend nor indemnify the Foundation, but DENIES it to the extent it seeks dismissal of the Foundation's bad faith claim. The court DENIES the Foundation's motion (Dkt. # 33) for summary judgment.

Trial in this matter is set for March 29, 2010. The court notes that the parties have already participated in mediation. Until now, the parties' disputes have focused on their disagreements over the meaning of the Policy and its application to the Craft litigation. The parties may wish to revisit settlement discussions to focus on their dispute over Great American's bad faith, and they should contact the court if it can be of assistance.

DATED this 1st day of March, 2010.

Richard D. Jones

The Honorable Richard A. Jones
United States District Judge